

FINAL OVERVIEW OF THE 2002-03 BUDGET

(CHAPTER 379, STATUTES OF 2002)

Senator Steve Peace, Chair
Senate Committee on Budget and Fiscal Review

September 13, 2002

2002-03 GENERAL FUND CONDITION

On June 30, 2002, the state ended its fiscal year with a \$1.4 billion deficit. The 2002 budget package finances this deficit and makes significant adjustments to address the state's ongoing budget shortfalls.

The Department of Finance estimates that the state ends the 2002 budget year with a \$1 billion surplus. General Fund revenues are estimated to be *nearly \$2.5 billion higher than expenditures* for the fiscal year starting on July 1, 2002. Relative to the 2001 budget, the 2002 budget *reduces General Fund spending* slightly.

The General Fund condition is summarized in Table 1.

Table 1
General Fund Condition
2001-02 and 2002-03
Dollars in Millions

	<u>2001-02</u>	<u>2002-03</u>	<u>Difference</u>
<i>Beginning Resources</i>	\$3,037	\$72	-\$2,965
<i>Revenues and Transfers</i>	<u>73,898</u>	<u>79,158</u>	<u>5,260</u>
Total, Resources	\$76,935	\$79,230	\$2,295
Expenditures	\$76,863	\$76,722	-\$141
Fund Balance	\$72	\$2,508	
Encumbrances	\$1,473	\$1,473	
Special Fund for Economic Uncertainties (commonly known as the "Reserve")	-\$1,401	\$1,035	\$2,436

OVERVIEW OF THE 2002-03 BUDGET

After reviewing the state's likely fiscal condition, the Governor advised the Legislature that the state faced the largest deficit in its history. On May 14, the Governor estimated that without correction the state faced a \$24 billion gap between spending and available resources for the year ending June 30, 2003. The deficit was nearly one-third of the General Fund.

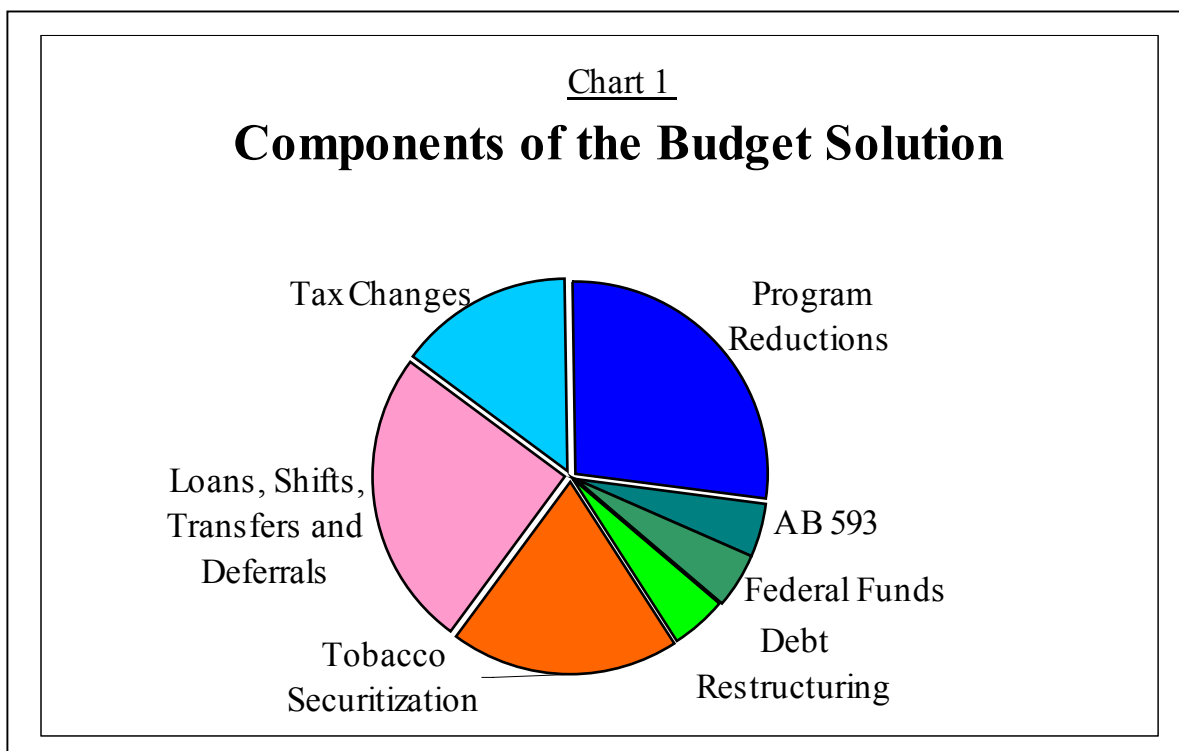
Erosion of General Fund Revenues since 2001. How did the deficit appear? When the Legislature passed the 2001-02 budget last July, the Department of Finance (DOF) estimated that resources would exceed expenditures by \$2.6 billion. DOF also estimated that the state's General Fund revenue stream would continue to grow at a rate sufficient to support spending at the levels budgeted for 2002-03.

Since the Legislature passed the 2001-02 budget, however, revenues eroded dramatically. Table 2 details the difference between the General Fund revenue forecast used to craft the 2001 Budget Act and the forecast presented in the 2002 May Revision. It shows that since July 2001, estimates of state revenues have fallen by over \$19 billion for the two-year period ending in June 2003. These revenue shortfalls account for more than 80 percent of the deficit.

<p style="text-align: center;"><u>Table 2</u> Difference in Revenue Estimates July 2001 vs. May 2002 Dollars in Billions</p>			
	<u>2001-02</u>	<u>2002-03</u>	<u>Totals</u>
July 2001 Estimate	\$ 75.1	\$ 80.2	\$155.3
May 2002 Estimate	<u>66.5</u>	<u>69.6</u>	<u>136.1</u>
<i>Difference in Revenue Estimates</i>	<i>-\$8.6</i>	<i>-\$10.6</i>	<i>-\$19.2</i>

Expenditures also increased during the same period. Perhaps as much as 20 percent of the deficit is associated with higher-than-anticipated expenditures.

Filling the Hole. By a combination of actions, including spending cuts, special fund transfers and tax changes, the Legislature filled the deficit. The relative value of the actions is displayed in Chart 1.



More specifically, the Legislature took the following actions:

1. *Spending Reductions.* In January, the Legislature passed SB 1 XXX which reduced spending by \$2.2 billion in 2001-02 and \$.7 billion in 2002-03, thereby reducing the deficit by a total of about \$3 billion. The Budget Act (AB 425) reduced spending by another \$3.6 billion, for a total reduction of about \$6.5 billion.

The Budget Detail section of this report describes changes in the budget relative to the Governor's January 10 budget.

2. *AB 593* authorizes the Governor to reduce spending by \$1 billion more than authorized by SB 1 XXX and AB 425. Specifically, AB 593:
 - Authorizes the Director of Finance to reduce appropriations for state operations by as much as \$750 million. It is not clear whether the Director has sufficient statutory or administrative discretion to achieve this magnitude

of savings. As such, it is unlikely that all the savings attributable to the Director's authority to make "unallocated reductions" will materialize.

- Requires the Governor to issue an executive order to authorize early retirement for state employees. The early retirement provision is sometimes referred to as a "golden handshake" provision. All state employees would qualify for the handshake, including those supported by the special funds. Assembly staff estimate that this provision will save the state General Fund \$285 million.

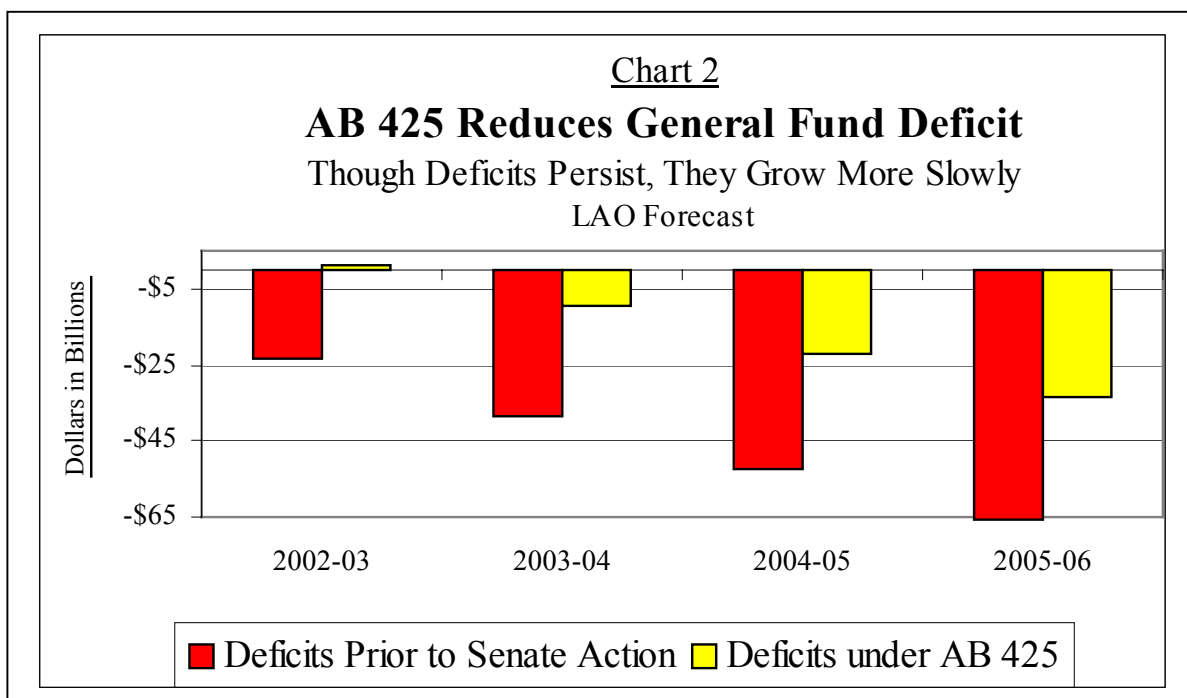
The unallocated reduction authority and golden handshake requirement are intended to create savings in addition to the reductions authorized specifically in SB 1 XXX and AB 425.

3. *Loans, Shifts, Transfers, and Deferrals.* The budget package includes loans, shifts, and transfers from special funds to the General Fund. Cumulatively, these changes increase General Fund resources by \$4.3 billion. The loans and transfers are detailed at the end of this essay. In addition, the budget agreement defers a payment to schools, saving the General Fund about \$1.7 billion in 2002-03. Taken together, these actions reduce the deficit by about \$6 billion.
4. *Tobacco Settlement.* The Legislature authorized securitizing the tobacco settlement, for a gain in General Fund resources of about \$4.5 billion.
5. *Federal Funds.* The budget assumes that federal funds will increase by about \$1.1 billion.
6. *Debt Restructuring.* By revising the state's debt payments, the Treasurer reduced state debt payments in 2002-03 by about \$1 billion (General Fund).
7. *Tax Law Changes.* The Assembly leadership negotiated a set of tax changes that generate \$2.4 billion in additional revenue for 2002-03. These changes were included in AB 2065. Table 2 summarizes the revenue impact for changes for the 2002-03 fiscal year.

Table 2
Tax Law Changes in AB 2065
 Dollars in Millions
 (effect on General Fund Revenues for 2002-03)

Suspend Net Operating Loss for Two Years <i>(and increase tax relief in outyears)</i>	\$ 1,200
Increase Withholding on Stock Options <i>(accelerates collection of tax, but does not increase tax)</i>	400
Increase Withholding on Real Estate Transactions <i>(accelerates collection of tax, but does not increase tax)</i>	225
Conform to Federal Law on Bad Debt	285
Suspend Teacher Tax Credit	170
Collection on High Risk Accounts <i>(authorizes settlement of disputed taxes)</i>	<u>145</u>
Total, Tax Changes (AB 2065)	\$ 2,425

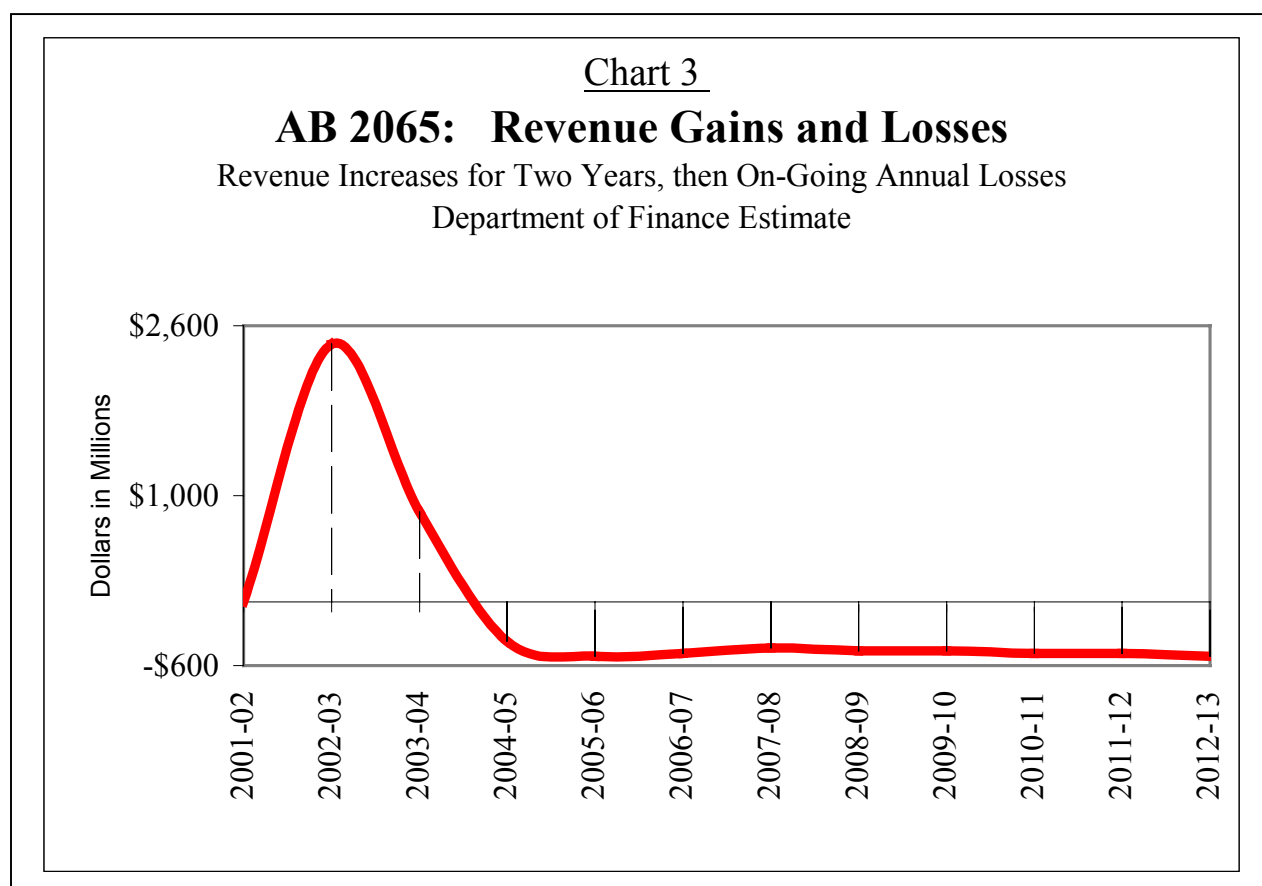
The 2002 Budget Package Improves the State's Out-Year Fiscal Condition. The Legislative Analyst estimates that without the corrective action taken as part of the 2002 budget settlement, the state would run a cumulative deficit of \$65 billion for the four-year period ending on June 30, 2006.



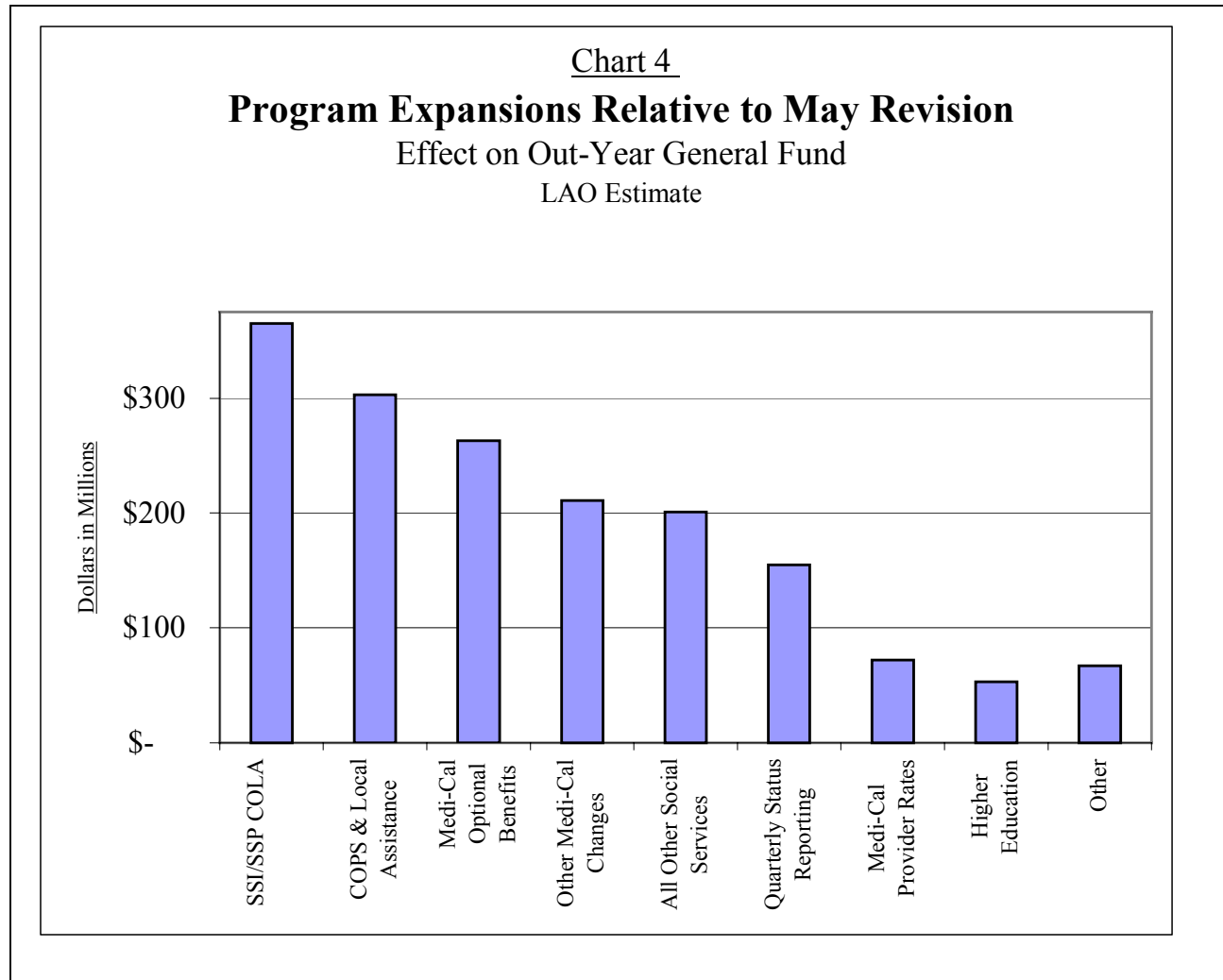
The budget package, with its combination of cuts, shifts, loans, deferrals and tax changes reduce the cumulative deficit from \$65 billion to about \$33 billion. Chart 2 compares the cumulative deficits that would have occurred under prior law and those which are forecast to occur under the provisions of the 2002 budget package.

Despite its general improvement in the state's fiscal condition, certain aspects of the 2002 budget package contribute to the out-year deficits. For example the tax bill, AB 2065, reduces General Fund revenues on a permanent basis in the out-years. Although the tax bill raises revenues in 2002-03 and 2003-04, it reduces General Fund revenues each year by about \$500 million.

The revenue losses are associated with increasing the amount of net operating losses (NOL) taxpayers may deduct beginning in 2005. Under the provisions of AB 2065, a taxpayer may now deduct 100 percent of his or her NOL, rather than the current-law 65 percent. Chart 3 displays the revenue impact of AB 2065 for the period ending June 30, 2013.



Several program expansions authorized in the budget package increase future spending and therefore contribute to the on-going deficit. The LAO estimates that these expansions will increase General Fund costs in 2003-04 by about \$1.6 billion.



These expansions are summarized in Chart 4. As displayed in the chart, the largest increase finances the cost-of-living adjustment for the aged, blind and disabled recipients of SSI/SSP. The second largest increase provides funding for local assistance programs, including law enforcement programs, like the COPS program.

LOANS AND TRANSFERS TO THE GENERAL FUND

The budget authorizes loans and transfers from special funds to address the shortfall in the General Fund. Loans may total nearly \$2 billion and transfers over \$500 million. Pages 11 and 13 detail the loan and transfer authorities in the 2002 budget package.

Loan Conditions. AB 3000 sets conditions makes for the loans. Money may be loaned from one state fund or account, provided that the following conditions are met:

- 1) The loan is authorized in the Budget Act,
- 2) The terms and conditions of the loan are set forth in the loan authorization, including an interest rate,
- 3) The loan is considered part of the balance of the fund or account, and
- 4) Fees and assessments will not be increased as a result of the loan.

Loaned moneys may not be considered a transfer of resources for purposes of determining the legality of using the funds.

AB 3000 requires the Director of Finance to order the repayment of all or a portion of the loan if either the fund or account *making the loan* needs cash, or the fund or account *receiving the loan* does not need the money.

Reporting Requirements. AB 3000 requires DOF to report to the Joint Legislative Budget Committee (JLBC) whenever a fund or account repays its loan. Annually, it must also report to the committee year-end balances for each outstanding loan.

The Governor's Budget, released on or before January 10 of each year, must also detail any outstanding loan balances.

Table 3
Special Fund Loans Contained in the 2002 Budget Package

Loans by Budget Item Number, Department and Fund
Dollars in Millions

Item Number	Department	Description	Total
0845-011-0217	Insurance	Insurance Fund	\$ 10
0959-011-0169	CA Debt Allocation Committee	Fund	2
0968-011-0448	CA Tax Credit Allocation Committee	Occupancy Compliance Monitoring Account	35
0968-011-0457	CA Tax Credit Allocation Committee	Tax Credit Allocation Fee Account	27
0974-011-0930	CA Pollution Control Fin. Authority	Pollution Control Financing Authority Fund	25
1111-011-0421	Automotive Repair	Vehicle Inspection and Repair Fund	100
1111-011-0069	Bureau of Barbering & Cosmetology	Fund	9
1120-011-0704	Board of Accountancy	Accountancy Fund	6
1170-011-0773	Behavioral Sciences	Behavioral Science Examiners Fund	6
1230-011-0735	Contractors' State License Board	Contractors' License Fund	11
1250-011-0741	Dental Board	State Dentistry Fund	5
1450-011-0310	Board of Psychology	Psychology Fund	5
1485-011-0264	Osteopathic Medical Board	Osteopathic Medical Board Contingent Fund	3
1490-011-0767	Pharmacy Board	Pharmacy Board Contingent Fund	6
1510-011-0761	Board of Registered Nurses	Registered Nursing Fund	12
1530-011-0775	Structural Pest Control Board	Structural Pest Control Fund	2
1760-011-0006	General Services	Disability Access Account	10
1760-011-0328	General Services	Pub. Schl. Plan., Design & Constr. Review Revolving Fd	35
1760-013-0002	General Services	Property Acquisition Law Money Account	3
2150-011-0298	Financial Institutions	Financial Institutions Fund	2
2150-011-0299	Financial Institutions	Credit Union Fund	3
2180-011-0067	Corporations	State Corporation Fund	20
2240-011-0530	Housing & Comm. Dev'ment	Mobilehome Park Purchase Fund	8
2240-116-0929	Housing & Comm. Dev'ment	Housing Rehabilitation Loan Fund	20
2320-011-0317	Real Estate	Real Estate Commissioner's Fund	11
2660-011-3007	Caltrans	Traffic Congestion Relief Fund	1,045
SB 1834	Caltrans	State Highway Account	123
2920-115-0440	Tech, Trade & Commerce	Petroleum Underground Storage Tank	17
2920-115-0521	Tech, Trade & Commerce	Fund	8
2920-115-0694	Tech, Trade & Commerce	Petroleum Financing Collection Account	1
2920-115-0918	Tech, Trade & Commerce	Small Business Expansion Fund	11
3360-011-0382	Energy Commission	Renewable Resource Trust Fund	150
3480-011-0133	Conservation	Beverage Container Recycling Fund	218
3960-011-0014	Toxics	Hazardous Waste Control Account	15
8570-112-0111	Food and Agriculture	Agriculture Fund	15
Total, Loans			\$ 1,978

Table 4
Special Fund Transfers Contained in the 2002 Budget Package
 Transfers by Budget Item Number, Department and Fund
 Dollars in Millions

Item Number	Department	Description	Total
0450-111-0159	State Trial Court Funding	Trial Court Improvement Fund	\$ 43
0820-011-0017	Department of Justice	Fingerprint Fees Account	2
0820-011-0378	Department of Justice	False Claims Act Fund	2
0890-011-0228	Secretary of State	Business Fees Fund	1
0890-011-0274	Secretary of State	Business Reinvestment Fund	3
2180-012-0067	Corporations	State Corporations Fund	9
2240-011-0474	Housing and Community	Childcare and Development Facilities	3
2240-115-0843	Housing and Community	Housing Trust Fund	2
2240-115-0949	Housing and Community	Housing Rehabilitation Loan Fund	1
2660-012-0041	Caltrans	Aeronautics Account	6
2660-015-0042	Caltrans	State Highway Account	14
2920-115-0649	Tech, Trade, & Commerce	Infrastructure and Economic	8
2920-115-0809	Tech, Trade, & Commerce	Export Finance Fund	8
3360-011-0381	Energy Commission	Pub. Interest Research, Dev. & Dem.	7
3360-011-0382	Energy Commission	Renewable Resource Trust Fund	7
3480-011-0141	Conservation	Soil Conservation Fund	1
3600-002-0643	Fish and Game	Upper Newport Bay Ecological	1
3640-011-0447	Wildlife Conservation Board	Wildlife Restoration Fund	3
3680-011-0560	Boating and Waterways	Small Craft Harbor Improvement Fund	5
3790-011-0392	Parks	Parks and Recreation Fund	20
3860-011-0050	Water Resources	Colorado River Management Account	22
3960-011-0018	Toxics	Site Remediation Account	1
4260-012-0099	Health Services	Health Statistics Special Fund	4
5100-011-0184	Employment Development	EDD Benefit Audit Fund	10
5100-011-0185	Employment Development	EDD Contingent Fund	25
5180-011-0270	Social Services	Technical Assistance Fund	1
C.S. 24.30	School Facilities Aid	State School Building Aid Fund	25
8350-011-0222	Industrial Relations	Workplace Health and Safety Revolving	4
8350-011-0223	Industrial Relations	Workers' Compensation Administration	3
8350-011-0284	Industrial Relations	Loss Control Certification Fund	2
8350-011-3022	Industrial Relations	Apprenticeship Training Contribution	1
8660-011-0464	Public Utilities Commission	High-Cost Fund A	27
8660-011-0470	Public Utilities Commission	High-Cost Fund B	251
Total, Transfers			\$ 523

BUDGET PACKAGE (“TRAILER BILLS”)

What we commonly refer to as the “budget” is a package of legislation necessary to implement the state’s annual spending plan. The package includes the budget bill, which appropriates General Fund and special fund revenues. The budget bill usually includes language limiting the use of the appropriations. This year’s bill, AB 425, was passed by the Legislature on August 31, 2002.

Any statutory changes necessary to implement the budget bill, often contained in legislation referred to as “trailer bills,” are passed to the Governor with the budget bill.

The list below details the budget package passed by the Legislature as part of the 2002 Budget.

Vehicle	Author	Subject
AB 425	Oropeza	2002 Budget Act
AB 442	Budget Committee	Health omnibus
AB 444	Budget Committee	Social services omnibus
AB 593	Oropeza	Unallocated reductions & golden handshake
AB 692	Aroner	Clean up of AB 444
AB 1100	Simitian	Education (Simitian provisions)
AB 1768	Oropeza	General government clean up
AB 2065	Oropeza	Tax changes
AB 2781	Oropeza	Education finance
AB 2785	Oropeza	Education clean up
AB 2996	Budget Committee	Transportation omnibus
AB 2997	Budget Committee	Resources omnibus
AB 2998	Budget Committee	Charter schools
AB 3000	Budget Committee	General government
AB 3004	Budget Committee	Forgiveness for City of Millbrae
AB 3006	Budget Committee	Medi-Cal provider rate change
AB 3008	Budget Committee	Education finance (current year deferral)
AB 3009	Budget Committee	ERPA tax authority & defer natural heritage tax credit
AB 3010	Budget Committee	Unemployment insurance (alternate base)
AB 3011	Budget Committee	Education finance (current year)
SB 1831	Peace	Tobacco securitization
SB 1834	Budget & Fiscal	Transportation loans
ACA 11	Richman	Infrastructure finance